

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 02-0262
INCOME TAX
FOR THE YEARS 1998 THROUGH 2000**

NOTICE: Under Ind. Code § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Income Tax – Unrelated Business Income Tax

Authority: IC 6-8.1-3-1(a); IC 6-8.1-1-1; IC 6-8.1-5-1(a); IC 6-8.1-5-1(b); 45 IAC 15-2-1; 45 IAC 15-5-1; IC 6-2.5-5-25; IC 6-2.1-3-23; IC 6-3-2-3.1(a); IC 6-3-1-17(a); 45 IAC 3.1-1-68; IC 4-32-9-2; IC 4-32-9-17; IRC Sec. 513;

Taxpayer protests the Department's assessment of Unrelated Business Income Tax.

II. Tax Administration – Penalty

Authority: IC 6-8.1-10; 45 IAC 15-11-2

STATEMENT OF FACTS

The Indiana Department of Revenue Criminal Investigation Division initiated an investigation of the taxpayer. The Department's investigation report determined that they had conducted the sale of punchboards, pulltabs, and tipboards without a license from December 1, 1997 to November 30, 2000 in violation of IC 4-32-9-2.

I. Income Tax – Unrelated Business Income Tax

DISCUSSION

The Department's investigation report determined that the taxpayer conducted the sale of punchboards, pulltabs, and tipboards without a license from December 1, 1997 to November 30, 2000 in violation of IC 4-32-9-2. The taxpayer also failed to maintain any records in violation of IC 4-32-9-17. The Department determined that activities of taxpayer were unrelated to taxpayer's exempt purpose. Exemption from tax for exempt organizations is tied to the gross income tax provisions with respect to exempt organizations (See IC 6-2.5-5-25). As provided under IC 6-2.1-3-23, exempt organizations are not entitled to exemption from gross income received by a

taxpayer that is derived from an unrelated trade or business, as defined in Section 513 of the Internal Revenue Code. Thus, the Department's determination was guided by I.R.C. § 513, which provides, in part, the following:

...The term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

Pursuant to IC 6-3-2-3.1(a) and IC 6-3-1-17(a), the Indiana General Assembly has expressly adopted the Code's tax treatment, with respect to Code section 501(c) organizations, for purposes of the Indiana adjusted gross and supplemental income tax analysis. Moreover, the Department's rule 45 IAC 3.1-1-68 defines an unrelated trade or business under the same guidelines as Code section 513, and the rule also subjects any unrelated business income to the Indiana taxes. Additionally, the rule cites taxpayers to Code sections 511 through 515 for guidance in determining whether income is subject to the taxes. The Department in assessing unrelated business income tax reviewed the records of distributors of charity gaming supplies and determined the amount of games purchased for the periods involved. The taxpayer was assessed for the periods May 1, 1997 to April 30, 1998; May 1, 1998 to April 30, 1999; and May 1, 1999 to April 30, 2000. The amount of tax assessed was \$941.69, \$919.37, and \$1,534.27 respectively. At hearing, the taxpayer stated that they did not agree with the amounts assessed. The Department reviewed the billings and determined that the unrelated business income tax calculations were in fact incorrect. The actual amounts should have been \$432, \$591, and \$826. The Department will make the appropriate adjustments.

Pursuant to IC 6-8.1-3-1(a), the Department "has the primary responsibility for the administration, collection, and enforcement of the listed taxes,"(IC 6-8.1-1-1). Under 45 IAC 15-2-1, the Department was established for the purpose of administering, collecting and enforcing all taxes placed under its authority." Pursuant to IC 6-8.1-5-1(a), the Department "shall make a proposed assessment of the amount of the unpaid tax" when an audit discovers a failure to remit tax. *See also*, 45 IAC 15-5-1. Under IC 6-8.1-5-1(b), the "notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with" taxpayer.

At hearing, the taxpayer's Attorney stipulated that they did operate charity gaming for a period of three (3) years without a charity game license. Taxpayer alleged that their former Administrator, is responsible for the failure to obtain a gaming license from the Department. Taxpayer contends that their Administrator also embezzled all gaming monies. One of taxpayer's current officers stated, "I kind of blame the officers for part of this because they didn't check..." The taxpayer did not contact any law enforcement agency regarding the allegedly stolen money. When taxpayer was asked about whether they reported the money missing, "We were told that we should just report it to [their parent organization] and they'd take it to their bonding company." As a result of the organization being deceived by one of its members, the taxpayer argues that it should be allowed to file its past gaming applications retroactively, and pay a one

dollar (\$1.00) civil penalty for each year's violation, thus eliminating all but three dollars (\$3.00) of the civil penalties imposed by the Department and also any related tax implications. Petitioner also argues that it should only be required to pay a \$1.00 fine for its failure to keep accurate records.

IC 4-32-1-1 and the following statutes contain no provision for retroactively filing charity gaming applications. Assuming for the sake of argument, the taxpayer was allowed to file the forms retroactively, they still failed to account for any of the income received from gambling or file the appropriate forms as is required of all organizations conducting charity gaming.

FINDING

Taxpayer's protest is denied. However, the amount of tax due for the fiscal years 1998, 1999, and 2000 will be adjusted pursuant to this Letter of Findings.

II. Tax Administration – Penalty

DISCUSSION

The taxpayer protests the imposition of the ten percent (10%) negligence penalty. Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC 6-8.1-10. The Indiana Administrative Code at 45 IAC 15-11-2 provides in pertinent part:

(b) "Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

(c) The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;

- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case. In this instance, taxpayer was not negligent in its failure to apply for a charity gaming license.

FINDING

Taxpayer's protest is sustained.